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Legislative Council

LC Paper No. LS51/19-20

Legal Service Division Report on
Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Bill 2020

I. SUMMARY

1. **The Bill** The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to give effect to the policy initiative announced by the Chief Executive in the 2018 Policy Address and the Financial Secretary in the 2019-2020 Budget Speech to foster ship leasing activities in Hong Kong by giving profits tax concessions to qualifying ship lessors and qualifying ship leasing managers; to make provisions for profits tax purposes about businesses in connection with ships; and to make related amendments.

2. **Public Consultation** According to the Administration, it consulted individual industry stakeholders on the proposed dedicated tax regime for the ship leasing business during July to August 2019 and they expressed support for the proposal. The proposal was also presented to the Hong Kong Maritime and Port Board and the Hong Kong Shipowners Association in September and November 2019 respectively. The industry stakeholders supported the proposal.

3. **Consultation with LegCo Panel** As advised by the Clerk to the Panel on Economic Development, the Administration briefed the Panel on 26 November 2019 on the proposal to provide tax incentives for ship leasing. Members were generally supportive of the proposal and urged for its early implementation.

4. **Conclusion** The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the profits tax system, Members may consider setting up a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 18 March 2020. Members may refer to the Legislative Council ("LegCo") Brief (File Ref.: THB(T)PML 30/160/6/1) issued by the Transport and Housing Bureau in January 2020 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to give profits tax concessions to qualifying ship lessors and qualifying ship leasing managers; to make provisions for profits tax purposes about businesses in connection with ships; and to make related amendments.

Background

3. At present, assessable profits of a corporation arising in or derived from Hong Kong, including those profits arising from carrying on the ship leasing business in Hong Kong, are chargeable to profits tax at the rate of 8.25% (for the first $2 million of profits) (see section 2(a) of Schedule 8B to Cap. 112) and 16.5% (for profits above $2 million) (see section 2(b) of Schedule 8B to Cap. 112) for any year of assessment commencing on or after 1 April 2018.

4. The Chief Executive and the Financial Secretary announced respectively in the 2018 Policy Address and the 2019-2020 Budget Speech that the Government will introduce measures to attract ship finance companies to establish their presence in Hong Kong and develop Hong Kong as a ship leasing centre in the Asia-Pacific region. According to paragraph 9 of the LegCo Brief, the Administration proposes to introduce profits tax concessions for qualifying ship lessors and qualifying ship leasing managers to provide a conducive environment for ship leasing business in Hong Kong with a view to enhancing Hong Kong's position as an international maritime and financial centre.

Provisions of the Bill

5. The Bill seeks to amend Cap. 112 to give profit tax concessions to qualifying ship lessors and qualifying ship leasing managers. The major provisions are summarized in the following paragraphs.

<u>Proposed tax concessions for qualifying ship lessors and qualifying ship leasing managers</u>

6. The Bill proposes to add new sections 14P and 14T respectively to Cap. 112 to provide for the following profits tax concessions to qualifying ship lessors and qualifying ship leasing managers for a year of assessment commencing on or after 1 April 2020:

(a) the tax rate on the assessable profits of qualifying ship lessors derived from qualifying ship leasing activities would be 0% (as specified in the proposed new Schedule 8C) and;

(b) the tax rate on the assessable profits of qualifying ship leasing managers derived from qualifying ship leasing management activities would be (i) 8.25% (i.e. one-half of the profits tax rate (i.e.16.5%) as specified in Schedule 8 to Cap. 112) if the activity is not carried out for an associated corporation; and (ii) 0% (as specified in the proposed new Schedule 8C) if the activity is carried out for an associated corporation.[1]

7. For the purposes of computation of the assessable profits of a qualifying ship lessor under the proposed new section 14P(1), the net lease payments for operating leases and the net payments of finance charges or interest for funding leases derived from its qualifying leasing activity are proposed to be calculated in accordance with the formula in the proposed new sections 14R(2) and (3) and 14S(2) respectively. The effect of the proposed new sections 14R(2) and (3) and 14S(2) is that the tax base in respect of an operating lease would generally be equal to 20% (which is the prescribed percentage in Part 2 of the proposed new Schedule 17FA) of the lease payments, after deduction of expenses (excluding depreciation), derived by a qualifying ship lessor. The tax base in respect of a finance lease would be equal to finance charges or interest, after deduction of expenses, received by a qualifying ship lessor.

8. The proposed tax concessions would apply to a corporation that is a qualifying ship lessor or a qualifying ship leasing manager for a year of assessment only if:

(a) during the basis period[2] for that year of assessment — (i) the central management and control of the corporation is exercised in Hong Kong; (ii) the activities that produce qualifying profits for that year are carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong; and (iii) those activities are not carried out by a permanent establishment outside Hong Kong (proposed new sections 14P(4)(a) and 14T(5)(a)); and

(b) the corporation has elected in writing that the proposed tax concession applies to it (proposed new sections 14P(4)(b) and 14T(5)(b)).

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1 "Associated corporation", in relation to a corporation, means — (a) another corporation over which the corporation has control; (b) another corporation that has control over the corporation; or (c) another corporation that is under the control of the same person as is the corporation (see the proposed new section 14O(1)).

2 "Basis period" in any year of assessment is the period on the income or the profits of which tax for that year ultimately falls to be computed (see section 2(1) of Cap. 112).

Eligibility as a qualifying ship lessor

9. To be eligible as a qualifying ship lessor, a corporation needs to satisfy the following conditions in the proposed new section 14P(2):

(a) it is not a ship operator;

(b) it has carried out in Hong Kong one or more qualifying ship leasing activities as defined in the proposed new section 14O(5) (i.e. the ship leasing activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and the ship is of over 500 gross tonnage and is navigating solely or mainly outside the waters of Hong Kong); and

(c) it has not carried out in Hong Kong any activity other than a qualifying ship leasing activity.

Eligibility as a qualifying ship leasing manager

10. The proposed new sections 14T, 14U and 14V seek to provide for the circumstances under which a corporation may be qualified as a qualifying ship leasing manager. To be eligible as a qualifying ship leasing manager, a corporation should not be a ship operator and needs to satisfy one of the following conditions:

(a) it has carried out in Hong Kong one or more qualifying ship leasing management activities as defined in the proposed new section 14O(7)[3] and has not carried out in Hong Kong any activity other than a qualifying ship leasing management activity (proposed new section 14T(2)(b)(i) and (3));

(b) it satisfies the safe harbour rule under which the corporation is required to fulfil certain conditions regarding its ship leasing management profits and ship leasing management assets for the year of assessment concerned under the "1-year safe harbour" (proposed new sections 14T(2)(b)(ii) and 14U(2)), or for the year of assessment concerned and the preceding one or two years of assessment under the "multiple-year safe harbour" (proposed new sections 14T(2)(b)(ii) and 14U(3)); or

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3 Under the proposed new section 14O(7), a ship leasing management activity carried out by a corporation in respect of a ship is a qualifying ship leasing management activity if (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; (b) the activity is carried out for another corporation during the basis period of the other corporation for a year of assessment; (c) the other corporation is a qualifying ship lessor for that year of assessment; and (d) the ship is leased by the other corporation to a ship lessor, ship leasing manager or ship operator when the activity is carried out.

(c) it has obtained a determination of the Commissioner of Inland Revenue ("the Commissioner") that the corporation, which is not otherwise qualified, is a qualifying ship leasing manager if the Commissioner is of the opinion that the relevant conditions in (a) or the safe harbour rule in (b) above would, in the ordinary course of business, have been satisfied for the year of assessment concerned (proposed new sections 14T(2)(b)(iii) and 14V(3)).

Safeguards to prevent abuse of the proposed tax concessions

11. The Bill proposes to add new sections 14Y, 14Z and 14ZA to Cap. 112 to prevent avoidance of profits tax by means of the proposed tax concessions. Some of the proposed safeguards are summarized below:

(a) profits from a transaction between a qualifying ship lessor or a qualifying ship leasing manager and its associates will be assessed by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties which are not associated (proposed new section 14Y); and

(b) the proposed tax concessions under the Bill would not apply if a corporation that is a qualifying ship lessor or a qualifying ship leasing manager enters into an arrangement which, in the opinion of the Commissioner, has the main purpose, or one of the main purposes, to avoid, postpone or reduce the liability to pay tax under Cap. 112 or under an arrangement made between two jurisdictions affording relief from double taxation (proposed new section 14ZA).

Deeming certain amount as trading receipts chargeable to tax

12. Clause 6 of the Bill seeks to amend section 15 of Cap. 112 by adding a new section 15(1)(o) and (1E) to deem sums received by or accrued to a corporation from carrying on certain businesses relating to ships as trading receipts chargeable to tax in Hong Kong even if the ships are used outside Hong Kong.

Other amendments

13. The Bill also seeks to provide for certain consequential arrangements, and transitional arrangements for calculating the qualifying profits for the proposed tax concessions by excluding the relevant sums received by or accrued to a corporation before 1 April 2020 (proposed new Schedule 51).

Commencement

14. The Bill, if passed, would come into operation on the day on which it is published in the Gazette as an Ordinance.

Public Consultation

15. According to paragraphs 21 and 22 of the LegCo Brief, the proposed dedicated tax regime for ship leasing business was developed by the Task Force on Ship Leasing under the Hong Kong Maritime and Port Board ("Task Force") where tax, financial, legal and maritime experts as well as relevant Government bureaux and departments are represented. The Administration consulted individual industry stakeholders on the Task Force's proposal during July to August 2019 and they expressed support for the proposal. The proposal was also presented to the Hong Kong Maritime and Port Board and the Hong Kong Shipowners Association in early September and early November 2019 respectively. Industry stakeholders supported the proposal.

Consultation with LegCo Panel

16. As advised by the Clerk to the Panel on Economic Development, the Administration briefed the Panel on 26 November 2019 on the proposal to provide tax incentives for ship leasing. Members were generally supportive of the proposal. Members urged the Administration to ensure the competitiveness of the proposed tax measures in attracting ship leasing business to set up offices in Hong Kong and formulate strategies to promote the new tax regime to achieve the potential benefits of the proposal. Supplementary information provided by the Administration was issued to members via LC Paper No. CB(4)221/19-20(01). Members discussed the threshold requirements to be met for a ship leasing activity or ship leasing management activity to be considered as carried out in Hong Kong. Some members suggested raising the minimum thresholds on the number of full-time qualified employees to create more employment opportunities for local people.

Conclusion

17. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the profits tax system, Members may consider setting up a Bills Committee to study the Bill in detail.

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